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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation	)	MM Docket No. 92-266
	)	
Leased Commercial Access	)	CS Docket No. 96-60

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Comcast Cable Communications, Inc. ("Comcast") and Cox Communications, Inc. ("Cox") hereby submit their reply comments in response to the Federal Communications Commission's *Further Notice of Proposed Rulemaking* in the above-referenced proceeding.[1]

INTRODUCTION AND SUMMARY

In our initial comments, we argued that the Commission should not replace the current "highest implicit fee" formula for setting maximum reasonable leased access rates with the cost-based formula set forth in the *Further Notice*. As we showed, the current formula is certainly not deterring part-time programmers. Indeed, because part-time rates are based on a

1/ *Order on Reconsideration of the First Report and Order and Further Notice of Proposed Rulemaking*, MM Dkt. No. 92-266, CS Dkt. No. 96-60, FCC 96-122 (rel. March 29, 1996) (the "*Further Notice*").

pro-rating of full-time rates -- taking no account of the additional costs associated with leasing capacity on a part-time basis, or of the market rates for comparable access to competing media -- they are in most cases too *low*. Other comments confirm that this is the case.

We also showed that leased access is not, for many types of *full-time* cable programmers, an economically viable means of distributing programming at *any* rate. Indeed, the comments of other parties confirm that, because there is generally no way for tiered leased access programmers to recover subscriber fees, leased access -- even at the lowest possible rates -- is likely to be viable primarily for shopping and infomercial channels. For those programmers, the current rates are not excessive and generally reflect the rates paid by similar services for carriage on cable systems. In fact, programmers of this type are currently using leased access channels.

In contrast, the proposed cost-based formula would produce maximum rates that are too low to compensate cable operators for the costs associated with making leased access channels available. This is because, as many parties point out, the formula does not recognize the full value to cable operators of the programming services that are displaced by leased access channels. And it disregards as "speculative" the adverse effects on revenues of displacing services chosen by cable operators with leased access programming that is less valued by -- and may even offend -- present and potential subscribers. Moreover, even commenting parties that believe that the existing formula should be replaced agree that the proposed cost-formula is unduly complicated and burdensome -- unlike the easily applied implicit fee approach.

As some parties have pointed out, the current "highest implicit fee" approach, while 'sound in theory, may be somewhat flawed in practice. In theory, the implicit fee for each program service is the difference between the licensing fee that the cable operator pays the program service and the amount that the operator charges subscribers for the service. With respect to tiered services, however, the current formula compares the actual licensing fee for each service with the *average* per-channel charge to subscribers. This may not accurately identify the true implicit fee for each channel or the highest implicit fee. Comparing the *average* licensing fee for all non-premium services with the average per-channel charge to subscribers, as proposed by several parties, would more accurately measure the average implicit amount "paid" to operators by programmers on a tier.

It would be reasonable, however, to charge leased access programmers more than the average channel rate, because cable operators typically receive benefits from the services carried on their system that they do not receive from leased access programmers. Therefore, a surcharge or mark-up should be added to the average channel rate, as proposed by Cox and by the National Cable Television Association.

I. LEASED ACCESS RATES ARE NOT UNREASONABLE.

Several parties to this proceeding seem to believe that the measure of whether leased access rates are reasonable is whether the parties can themselves afford to purchase time at those rates.[2] This, of course, is not the statutory test. As we and others pointed out, any

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2/ *See, e.g.*, Community Broadcasters Assn. Comments at 2 n.2 ("If leasing is not economically viable, the intent of Congress that programming be presented on cable that is not subject to the cable operator's editorial control will not be fulfilled."); Blab Television Network reasonableness standard should take into account the existing marketplace for carriage of cable programming services and may not require rates to be set at levels that "adversely affect the operation, financial condition, or market development of cable systems."[3] This may result in rates that are uneconomical for some program providers, but, as Shop at Home, Inc. points out, the Commission has no statutory mandate "to ensure the success of the leased access option" by setting rates at levels that are uneconomical for cable operators.[4]

Indeed, as several parties have confirmed, the economics of leased access would inherently preclude its use by most types of programmers "even if the maximum leased access rates were substantially reduced"[5] because most programmers -- including most "high quality entertainment programmers"[6] and "new services that are not wholly advertiser-funded"[7] -- rely on subscriber fees, which are generally not available to leased access programmers. Thus, "[o]nly those programs that receive revenues exclusively from merchandise sales or advertising,

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Comments at 6-7 (arguing that leased access rates should be set "in the 4¢ to 8¢ per subscriber per month range" because "Blab TV's experience has shown that higher rates are not commercially viable for local origination programming); Game Show Network Comments at 6 ("the Commission's new rules should satisfy the Congressional directive to establish 'reasonable' rates that will result in far more affordable leased access rates than are possible under the current regime").

3/ 47 U.S.C. § 532(c)(1).

4/ Shop at Home, Inc. Comments at 2, citing "Congress' unequivocal mandate that operators are not to subsidize leased access users."

5/ *Id.* at 3.

6/ *Id.*

7/ Besen and Murdoch, *The Impact of the FCC's Leased Access Proposal on Cable Television Program Services* (attached to Turner Broadcasting System, Inc. Comments).

such as home shopping networks and infomercials, could afford leased access. . . ."[8] In fact, those types of services *are* making use of leased access under the current rules -- although not at the subsidized rates that they might prefer. Thus, although ValueVision supports replacement of the current formula with the proposed cost-based approach, it notably does not state that access at current rates is unaffordable[9] -- and, in fact, ValueVision is currently leasing channels on at least four of Cox's systems.[10]

Some prospective full-time programmers nevertheless complain that their use of leased access has been deterred by the current rate formula, which supposedly produces rates that overcompensate cable operators. They echo the Commission's suggestion that the formula gives operators a "double recovery" insofar as it allows operators to charge programmers for access *and* to charge subscribers for the leased access programming.[11] But, as we showed in our initial comments, any double recovery in connection with leased access programming is likely to be *de minimis*, because subscribers are generally unwilling to pay more than a *de minimis* amount for leased access programming.[12] As explained by Shop at Home, "[t]he 'double counting' concern assumes that existing and potential cable subscribers are indifferent to the programming offered

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8/ Turner Broadcasting System Comments at 9. This may -- and often does -- include, in addition to traditional shopping and infomercial programming, sexually-oriented programming that promotes the use of "900"-number chat services and other similar products and services.

9/ *See* ValueVision Comments.

10/ Moreover, as previously noted, Cox's cable system in Myrtle Beach, S.C. currently carries *three* full-channel leased access programmers. *See* Cox Comments, Exhibit A.

11/ *See, e.g.,* Community Broadcasters Assn. Comments at 2.

12/ *See* Comcast Comments at 10-12; Cox Comments at 4-7.

on their local cable system. *This assumption is wrong.*"[13/] Subscribers do not, in fact, value all programming on a tier equally -- and, while leased access programmers generally tout the appeal of their own services to subscribers,[14/] or the "diversity" and "localism" that they would add to cable tiers,[15/] there is no reason to believe that cable subscribers would pay any significant amount for such programming. Therefore, there is no reason to suspect that leased access rates under the current formula are, with respect to full-time programmers, unreasonably high.

As to *part-time* leased access, nobody even suggests that current rates are unaffordable or are deterring use of available channels. To the contrary, the comments confirm that current part-time rates are generally too *low* -- with adverse effects on cable operators, cable programmers, and other media that sell time at far higher rates. Thus, as Access Television Network points out,

> [e]ven under the implicit fee formula, proration resulted in part-time rates that were set well below market rates for advertising on cable systems. . . . Should the Commission follow through with its proposal to apply a pro-rated cost/market rate formula (which will inevitably yield lower rates than the implicit fee formula) to part-time rates, the result will be to create subsidized part-time CLA rates that are far below the market-based rate for commercial advertising. Naturally, advertisers will migrate away from traditional cable advertising to the less costly CLA channels.[16/]

13/ Shop at Home, Inc. Comments at 3 (emphasis added). *See also, e.g.,* Economists Incorporated. *An Analysis of the Federal Communications Commission Maximum Reasonable Leased Commercial Access Rate*, Attachment A to National Cable Television Assn. ("NCTA") Comments, at 7-8.

14/ *See, e.g.*, The Game Show Network Comments at 3.4.

15/ *See, e.g.,* Blab Television Network Comments at 2-3; Community Broadcasters Assn. Comments at 8.

16/ Access Television Network Comments at 7. *See also* C-SPAN Comments at 9 ("Even under the current 'highest implicit fee' approach, part-time users of leased access have bumped either or both of the C-SPAN Networks on an hourly basis.")

Thus, there clearly would be no need to lower part-time rates in order to ensure greater affordability of leased access channels, even if greater affordability were the appropriate standard of reasonableness. To the contrary, the Commission should re-examine whether part-time rates are currently too low, and should, at a minimum, "ensure that part-time programming is priced comparably to commercial advertising time on cable systems."[17/]

II. THE PROPOSED COST-BASED FORMULA IS UNDULY COMPLEX AND PRODUCES UNREASONABLY LOW RATES.

Many commenting parties have identified the most obvious substantive flaw in the proposed cost-based formula -- which is that it disregards certain substantial and identifiable but not easily quantifiable "opportunity costs" imposed on cable operators by leased access. Specifically,

> [t]he cost model fails to account for the largest element of a measure of true "opportunity costs" -- the impact on subscriber revenues caused by replacing desirable cable programming services with programming that subscribers do not want or do not value as highly.[18/]

Therefore, the formula would undercompensate cable operators, in violation of the statutory mandate that leased access not impose a financial burden on cable operators.

By failing to take into account any diminished value of leased access programming to subscribers, the proposed formula also would *subsidize* leased access programmers to the detriment of other cable program services. As ESPN explains, it (and other programmers) have

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17/ Access Television Network Comments at 7.

18/ NCTA Comments at 12. *See also, e.g.*, Time Warner Cable Comments at 6; Continental Cablevision Comments at 13; Daniels Communications, et al. Comments at 11; US West Comments at 4-5.

> invested millions of dollars in programming, technology, image advertising, customer relations, and other marketing-related endeavors to "earn" and maintain carriage of its services on cable systems. The Commission's analysis ignores such investments which are aimed at creating a product that cable operators will want to carry and subscribers will be willing to purchase. Consequently, the Commission may fail to appreciate both the extent to which its current formula acts as a surrogate for these costs and the level of subsidy built into the proposed "cost" approach that allows leased access programmers to purchase distribution at pre-set rates without having to "invest" their way onto a cable system through the creation and marketing of desirable programming.[19]

ValueVision suggests that "the need for certainty in leased access rates" and the "opportunities for abuse" that would arise if operators were permitted to attempt "to quantify alleged losses in subscriber revenue resulting from the carriage of leased access programming" dictate that such opportunity costs be excluded from the cost formula.[20] But this argument misses the point. If it is not feasible for the proposed cost formula to take into account substantial costs imposed on cable operators by leased access, the solution is not simply to ignore those costs. The solution is to use a different approach that better reflects and incorporates *all* the costs incurred by operators in carrying leased access programming -- which is precisely what an implicit fee approach does.

In any event, the proposed cost formula hardly provides more certainty than the current approach. Indeed, even most of the commenting parties that support some reduction in the current maximum rates agree that the proposed cost formula is simply too complex and burdensome to be a workable substitute for the implicit fee approach. For example, the

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19/ ESPN, Inc. Comments at 4.

20/ ValueVision Comments at 8.

Community Broadcasters Association points out that the proposed formula is likely to lead to numerous disputes because it

> (a) involve[s] calculations based on information solely in the hands and under the control of cable operators; (b) the calculations can be highly complex, especially in terms of determining what revenues are foregone when a channel is leased; and (c) the calculations are different for every system and sometimes different for different channels on the same system.[21/]

Furthermore, several parties have pointed out the pitfalls and complications that would result from the requirement, inherent in the cost formula, that operators designate in advance the particular programming to be displaced by leased access users. As A&E Television Networks, *et al.* explain, the creation of such a "hit list" would be

> devastating for several reasons. In addition to the obvious loss of carriage, such a list would create undue alarm with viewers, third party programmers, investors and advertisers, causing a decrease in revenue and support even though the programmer may never be dropped.[22/]

In sum, the proposed cost formula is an unworkable and inaccurate measure of reasonable leased access rates. It would be an undesirable substitute for the current implicit fee approach, even if that approach were itself flawed. In any event, the implicit fee approach is a more workable and more accurate measure of the value and cost of leased access channels.

21/ Community Broadcasters Association Comments at 5-6. *See also, e.g.,* Center for Media Education Comments at 9-10; Lorilei Communications, Inc. Comments at 7; Prime Radiant Productions Comments at 2; United Broadcasting Corporation Comments at 4.

22/ A&E Television Network, *et al.* Comments at 57-58. *See also* ESPN, Inc. Comments at 8.

III. THE *AVERAGE* CHANNEL RATE, PLUS AN APPROPRIATE SURCHARGE, COULD MORE ACCURATELY REFLECT REASONABLE LEASED ACCESS RATES.

As we showed in our initial comments, the highest implicit fee approach is, in theory, a valid means of identifying reasonable leased access rates. Concerns that such an approach result in "double recovery" and overcompensation of cable operators are, for the reasons that we discussed, misplaced. On the other hand, as the Commission's formula makes clear, actually identifying the highest implicit fee -- at least, for programming that is included on a tier -- is problematic. While it is not difficult to identify the amount that the cable operator pays to each programmer on the tier, it is impossible to quantify the amount that subscribers pay for each service on the tier. Therefore, the current formula calculates the implicit fee for each programmer by comparing the actual licensing fees paid for the programming with the *average* per channel price paid by subscribers for the tier.

As Cox pointed out, such a comparison may not "yield a result that reflects either the actual value of each channel or the average value of all channels to cable operators and programmers."[23] Instead, Cox proposed that the formula for full-channel leasing be revised to calculate the *average* channel rate, by comparing the average per-channel price to subscribers with the *average* cost to the operator of the programming on the tier. In order to take into account the fact that "leased-access programmers do not provide cable operators with all the benefits that operator-selected program services provide and may, indeed, impose costs on the

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23/ Cox Comments at 10.

system," Cox proposed that "operators should be permitted to impose a reasonable surcharge" on this average rate.[24/]

The National Cable Television Association ("NCTA") has proposed a similar reasonable refinement of the current formula. Under the NCTA's proposed formula,

> [a]n operator would calculate its total programming costs for programming carried on [basic and expanded] tiers, and divide that cost by the total number of channels on its basic and CPS tiers. That per channel average programming cost would then be subtracted from the average per channel rate charged to subscribers to determine the average channel rate.[25/]

Then, operators should be allowed an 11.25% markup to "compensate operators for certain costs -- such as lost advertising revenues and administrative costs -- that leasing will impose that are not reflected in the average channel rate" and to "correct for undercompensation to operators for channels that are in fact more valuable than the average."[26/]

The NCTA approach would correct any perceived flaws in the current formula while producing rates that reasonably reflect the costs associated with leased access channels. If the current formula is to be revised, the NCTA approach is far superior to the cost-based approach and should be adopted.[27/]

24/ *Id.* at 11 n.10.

25/ NCTA Comments at 23.

26/ *Id.* As NCTA correctly points out, there is no reason to abandon the current "highest implicit fee" formula with respect to rates for premium, à la carte service. There is no problem in identifying the actual amounts paid by subscribers for *those* services, and, therefore, none of the distortions that may result from comparing actual licensing fees to *average* subscriber charges are present. *See id.,* n.61.

27/ But if there is to be a revision of the formula that effectively lowers leased access rates, there should, for the reasons set forth by NCTA, be a phased-in transition. *See* NCTA Comments at 26-28. Moreover, for the reasons discussed in Part I, *supra*, and in our initial comments, any revision in the formula that results in a reduction in rates should apply only to

CONCLUSION

For the foregoing reasons, and for the reasons set forth in our initial comments, the Commission should not replace the current formula for calculating maximum reasonable leased access rates with the proposed cost-based formula. The current approach, particularly with the refinements suggested herein, establishes maximum rates that are reasonable in light of the cost to operators and the value to programmers of leased access channels. Maximum rates for part-time leased access are already too low and, in order to take into account the costs of part-time usage and the existing market for commercial use of cable systems and other media, should be set at levels higher than the pro rated full-time levels.

Finally, for the reasons set forth in our initial comments, the Commission should not require operators to bump existing programmers or make new channels available for less than

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full-time channels and should not result in a corresponding pro rata reduction in part-time rates. As discussed above, the pro rata approach to part-time rates already produces rates that are, if anything, too low. Part-time rates should be established in a manner that reflects market rates for the sale of commercial time on cable systems and other media. Finally, we agree with the Commission's proposal that when all of a system's required leased access channels are in use, rates for such use should be determined by the marketplace and not by regulatory formula.

eight hours of leased access use, should not establish preferential leased access rates or set-asides for not-for-profit programmers, and should not permit the resale of leased access channel capacity.

Respectfully submitted,

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